

If all the criteria listed in subsection (a)(1)(A)-(E) of Section 130.1935 are met, then neither a transaction involving the licensing of software nor the subsequent software updates will be considered a taxable retail sale subject to Retailers' Occupation and Use Tax. See 86 Ill. Adm. Code 130.1935 (This is a GIL.)

July 10, 2003

Dear Xxxxx:

This letter is in response to your letter dated March 27, 2003 in which you request a Private Letter Ruling on the taxation of software updates and support delivered via the Internet. Due to the limited information contained in your letter, we are unable to provide you with a Private Letter Ruling. However, we are responding to your request with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See, 2 Ill. Adm. Code 1200.120 subsections (b) and (c), which can be found at <http://www.revenue.state.il.us/Laws/regs/part1200>.

In your letter you stated and made inquiry as follows:

By means of this letter, AAA is formally requesting a private letter ruling on the taxability of Optional Software Support that includes updates that are delivered solely through the Internet.

AAA is a public independent software company. AAA and its subsidiaries produce and sell computer software and provide a broad range of consulting, education and technical support services to customers throughout the world. AAA's product offerings primarily focus on enterprise infrastructure software. In general, the Company sells most of its software 'out of the box' although occasionally, the company will provide implementation services associated with its software that might include a degree of customization.

Under the Company's business model, it sells customers perpetual software licenses to its products. After the first year, the customer can obtain updates (new feature and functions including later versions of the original software and bug fixes) associated with the software product it has licensed, along with telephone support for the product, under a separate support agreement, which is renewed on a yearly basis. For most products, software updates and telephone support are priced together and are not sold separately.

Currently, the updates and bug fixes associated with the support agreement are generally provided to the customer on a tangible media (e.g., a computer disk). In response to customer demand, and as an enhancement in its business processes, in the future the Company will deliver its second year optional software support (i.e., the updates and bug fixes) via electronic downloads through the Internet.

### Facts

1. Current customers who have purchased software prior to 2003 have received the original software and all subsequent updates on a tangible medium.
2. With the initial purchase of the software license, support is mandatory and is separately stated on the invoice.
3. Subsequent software support is optional. It should be noted, however, that should the customer choose not to renew its support contract for the second year, but then chooses to renew the support contract in the third year, he must pay for both second and third year support to bring his software to the current version.

### Issues

1. Is the purchase of second year optional software support taxable if the transfer of the updates and bug fixes to the customer is done solely via the Internet?
2. Is the taxability of second year optional software support delivered via the Internet dependant upon the means used to deliver the initial software purchase (i.e., if the original software was delivered via tangible media, would all subsequent maintenance contracts be taxable regardless of the means used for delivery)?
3. If tangible user manuals are provided as part of the second year software support does it change the taxability of the sale?
4. If the software support is mandatory does it change the taxability of the Internet delivery?
5. If the software support is optional does it change the taxability of the Internet delivery?

We ask for the state to rule on the taxability of optional software support that includes the right to updates delivered solely through electronic means, so that we can be prepared to tax the product appropriately when this business change is made.

Should you require any additional information please do not hesitate to contact me.

Thank you in advance for your assistance in this matter. We look forward to your response.

The Illinois Retailers' Occupation Tax Act imposes a tax upon persons engaged in this State in the business of selling tangible personal property to purchasers for use or consumption. See 86 Ill. Adm. Code 130.101. Illinois imposes a Use Tax on the privilege of using in this State any kind of tangible personal property that is purchased anywhere at retail from a retailer. See 86 Ill. Adm. Code 150.101. If a sale does not involve the transfer of tangible personal property to the purchaser, then the Illinois Retailers' Occupation and Use Taxes do not apply.

In your letter you mention that most of the software AAA sells is “out of the box”. We take this to mean AAA mainly sells canned software or prewritten software. Canned software is considered tangible personal property regardless of the form in which it is transferred or transmitted, including tape, disc, card, electronic means or other media. The sale at retail, or transfer, of canned software intended for general or repeated use is taxable, including the transfer by a retailer of software which is subject to manufacturer licenses restricting the use or reproduction of the software. Charges for updates of canned software are also considered to be sales of software. Please refer to the enclosed copy of 86 Ill. Adm. Code 130.1935.

Generally, information that is downloaded is not taxable because it is considered an intangible. However, please note that this is not the case for downloading canned software. The Department’s regulation, 86 Ill. Adm. Code 130.2105 (copy enclosed) states in part:

“Information or data that is downloaded electronically, such as downloading books, musical recordings, newspapers or magazines, does not constitute the transfer of tangible personal property. These types of transactions represent the transfer of intangibles and are thus not subject to Retailers’ Occupation and Use Tax. However, downloads of canned software, as defined more fully in Section 130.1935 of this Part, are subject to Retailers’ Occupation and Use Tax.”

The tax applies to the entire charge made to the customer, including charges for all associated documentation and materials. Charges for training, telephone assistance, installation and consultation are exempt if they are separately stated from the selling price of the canned software. Maintenance agreements for software will be treated in the same manner as other maintenance agreements. Sellers of maintenance agreements must pay tax on their cost price of the materials transferred incident to the completion of a maintenance agreement. See Section 130.1935(b). However, if the agreement provides for updates of canned software and the updates are not separately stated and taxed, the entire maintenance agreement constitutes a sale of canned software and is subject to tax.

Sales of custom computer programs prepared to the special order of the customer may not be taxable retail sales. See subsection (c) of Section 130.1935. However, the selection of pre-written or canned programs assembled by vendors into software packages does not constitute custom software unless real and substantial changes are made to the programs or creation of program interfacing logic. See Section 130.1935(c)(3).

In your letter you state that AAA sells to customers “perpetual software licenses” to its products. A transaction involving the licensing of software will not be considered a taxable retail sale if such transaction meets all the criteria listed in subsection (a)(1)(A-E) of Section 130.1935. If all such criteria are met, then neither the transfer of software nor the subsequent software updates will be subject to Retailers’ Occupation and Use Tax. Section 130.1935(a)(1) states that a license of software is not a taxable retail sale if:

- A) It is evidenced by a written agreement signed by the licensor and the customer;
- B) It restricts the customer’s duplication and use of the software;
- C) It prohibits the customer from licensing, sublicensing or transferring the software to a third party (except to a related party) without the permission and continued control of the licensor;

- D) The licensor has a policy of providing another copy at minimal or no charge if the customer loses or damages the software, or of permitting the licensee to make and keep an archival copy, and such policy is either stated in the license agreement, supported by the licensor's books and records, or supported by a notarized statement made under penalties of perjury by the licensor; and
- E) The customer must destroy or return all copies of the software to the licensor at the end of the license period. This provision is deemed to be met, in the case of a perpetual license, without being set forth in the license agreement.

Therefore, if the licensing of computer software by AAA to its customers meets all the criteria set forth above, then neither the transfer of the software nor the subsequent updates of the licensed software would be considered a retail sale subject to Illinois sales tax. Such would be the case regardless of the fact that the licensed software and updates are downloaded via the Internet.

I hope this information has been helpful. The Department of Revenue maintains a Web site, which can be accessed at [www.state.il.us](http://www.state.il.us). If you have further questions related to the Illinois sales and use tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in item 1 through 8 of Section 1200.110(b). Such regulation may be obtained from our Web site mentioned above at <http://www.revenue.state.il.us/Laws/regs/part1200>.

Sincerely,

Dana Deen Kinion  
Associate Counsel

DDK:msk